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RHEHNSC/NSC WASHDC PRIORITY
RUEKJCS/JOINT STAFF WASHDC PRIORITY
RUCNDT/USMISSION USUN NEW YORK PRIORITY 1488
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S E C R E T SECTION 01 OF 03 HARARE 000884

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AF/S FOR HEIDY SERVIN-BAEZ, NSC FOR SENIOR AFRICA DIRECTOR
1C. COURVILLE, DEPARTMENT PASS TO EU MEMBER STATES COLLECTIVE

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SUBJECT: CENTRAL BANK HEAD - RUNNIN' OUT OF ZEROES

Classified By: AMBASSADOR DELL, REASONS 1.4 (b) (d)

Summary

11. (S/NF) Reserve Bank Governor Gideon Gono acknowledged to the Ambassador in a July 13 meeting that the Zimbabwean economy was in a state of crisis. Despite a modest drop in the annual rate, which he claimed reflected an abundant harvest, inflation remained the country,s greatest problem. It was affecting virtually everyone save for those few at the top who, ironically, were those targeted by western sanctions. Gono asked that the U.S. and the international community meet the GOZ more than halfway in extending assistance. The Ambassador responded that it was not a question of percentages but of timing. The GOZ had to accept the need for reform and begin reforms before the international community would provide assistance. The IMF vote, for instance, might have been quite different if the GOZ had begun implementing IMF policy recommendations rather than repaying its arrears. Gono conceded that the GOZ had made mistakes and needed to embrace reforms. End Summary.

State of the Economy

12. (S/NF) Gono began the meeting by showing the Ambassador his latest purchase, an oversize calculator the size of a small laptop computer. However, he ruefully noted that it no longer had enough zeros to help him calculate in Zimbabwean dollars. The Ambassador said that from a layman,s point of view, the economic collapse seemed to be accelerating. For instance, 6 months ago the largest Zimbabwean dollar note was 20,000; two months ago the 50,000 note was introduced and two weeks ago the 100,000 note. At this rate we would see ever larger denominations introduced at ever shorter intervals.

¶3. (S/NF) Gono responded that this was an accurate picture Zimbabwe,s rapidly worsening economy. Inflation remained the country,s number one problem. That said, the GOZ had reported a decline in inflation in the past week, which he attributed to the increased supply of food resulting from a better harvest this year. The Ambassador noted that Gono seemed to be implying that the laws of supply and demand did in fact work in Zimbabwe, contrary to President Mugabe,s assertions. Gono conceded the point. (N.B. The Central Statistical Office released data on July 10 that showed a drop in the annual inflation rate of 8.9 percent, to 1184.6 percent. However, sensitive reporting indicates that the GOZ,s internal calculations put the true rate of inflation is several multiples higher rapidly.)

¶4. (S/NF) Gono said inflation was affecting virtually everyone and everything in the country. The only exception was the political elite, who in a direct reference to western targeted sanctions, Gono referred to as &Specially Designated Persons8 (SDNs). Gono said corruption among these people was rampant and that turning the economy around would require removing their incentives to engage in corrupt practices. (Comment: Gono is himself an SDN and by all accounts a pretty corrupt one to boot.) Gono said the cause of inflation was primarily due to the poor performance of the agricultural sector, which he attributed to poor use of the land, especially the high rate of uncultivated land; 40 percent of the total. Despite the better harvest, Zimbabwe would still need to import food this year, perhaps as much as 600,000 metric tons (MTs) of maize to cover the traditional lean period from October to February.

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¶5. (S/NF) Gono said he planned to focus his next monetary policy statement, due before the end of July, on measures that would help improve agricultural performance and hinted that he would move to end the system of alternative exchange rates and subsidies for fuel that have allowed Zimbabwe,s elites to grow obscenely rich in the current climate. The Ambassador noted in that in some instances the RBZ's own policies either contributed to the problem, or worse were serving to further squeeze a struggling export sector. In that regard he cited his recent conversation with an American-affiliated tobacco firm whose officials had characterized the rules governing the sector as Byzantine and stacked against private enterprises. Although this firm wanted to continue doing business in Zimbabwe, it was sustaining multi-million dollar losses as the result of government policies and hyperinflation and would soon be forced to close its operation. The net result would be a further loss of exports and hard currency for Zimbabwe. A flustered Gono ordered his side to take note of this issue. The Ambassador said the U.S. planned to support a conference that the American Business Association of Zimbabwe (ABAZ) would be holding in October that would seek to highlight changes the GOZ could take to improve the business climate not just in the agricultural sector but throughout the economy. Gono applauded the initiative and asked to be allowed to speak to the conference.

International Relations

¶6. (S/NF) Gono said non-economic factors were also responsible for Zimbabwe,s economic crisis. Among the latter, the most significant was the poor state of Zimbabwe,s relation with the international community and especially western countries and institutions. The IMF vote in March had been a serious blow that had weakened reformers, including Gono himself, in the government. Gono acknowledged that Zimbabwe needed to undertake both economic and political reforms. However, the international community needed to show greater tolerance for Zimbabwe. The sanctions were too

punitive and were stifling the ability of the two sides to reach accord. He hoped the U.S. would lead the way in relaxing them and in leading the international community to meet the GOZ more than halfway) say 60/40.

¶7. (S/NF) The Ambassador responded that it was not a question of percentages but of who had to take the first step. The GOZ had to accept that sanctions were not responsible for the crisis and face to the need for fundamental reforms, both political and economic. Zimbabwe actually ran a healthy trade surplus with the U.S. and the EU, proof that the &sanctions8 were not general in nature and were not responsible for Zimbabwe,s economic problems. Gono, wincing, said it was a good point that he had hoped the Ambassador wouldn,t raise.

¶8. (S/NF) The Ambassador continued that the GOZ had to accept that the only way forward was to begin reforms and that the international community would not respond until it did so. In that regard, he noted that had Zimbabwe chosen to make only a small payment to the IMF but at the same time had to accepted and begun to implement the IMF,s policy recommendations, the result of the Board vote might have been very different. If the GOZ were to embark on a program of reform, not to please the international community but because it would be the right thing for Zimbabwe, it would find the U.S. a willing and reliable partner.

¶9. (S/NF) The Ambassador added that the GOZ had made a similar mistake with regard to the &Mkapa initiative.8 In

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effect the GOZ had rejected the UN,s efforts to be a mediator with the international community out of a fear that somehow this would &internationalize8 the Zimbabwean crisis. In doing so, Mugabe hadn,t scored a brilliant diplomatic coup, as the GOZ would have it, but rather had thrown away the last, best chance of getting external help in turning Zimbabwe around. To make the ideological point that the GOZ considered the crisis a bilateral dispute with the UK, the government had embraced an initiative that had no real substance and no real prospects.

¶10. (S/NF) The Ambassador closed by noting that whatever the issues between London and Harare, our policies toward Zimbabwe were grounded on our values and principles and the GOZ shouldn,t fool itself into thinking that it could improve relations with the U.S. if our concerns about democracy, human rights, and the rule of law were not addressed. Gono responded that beginning of wisdom was to acknowledge one,s mistakes and agreed that Zimbabwe had been guilty of many tactical errors in its relations with the U.S. and the international community.

Comment

¶11. (S/NF) Gono remains one of the few open and approachable senior figures in the GOZ. He is willing to talk and even to acknowledge the bankruptcy of GOZ policies. But the Governor is also both architect and implementer of policies that he knows are at best flawed and more typically ruinous. Gono,s assertions on the causes of inflation, for instance, glossed over the role that the RBZ has played by printing huge amounts of money, although he admitted as much by acknowledging the need to close the quasi-fiscal deficit. Beyond a slow and cautious attempt to begin closing down the cash cows that have created perverse incentives among the political elite, Gono offered no hint of the policy prescriptions he might offer in his monetary policy statement. We suspect he really has few options and that even this initiative has little prospect of succeeding against the venal interests of an entrenched leadership. In fact, we read his focus in the meeting on international sanctions as further evidence that the GOZ is not prepared to

tackle the real issues. There is in fact little or nothing Zimbabwe can do to dig itself out of its economic hole. For instance, there are rumors that Gono may announce a devaluation. However, a devaluation by itself, with no concrete reforms and no balance of payments support to back it, will only speed the currency's depreciation and further fuel the concomitant inflation.

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